



The Comptroller General
of the United States

Washington, D.C. 20548

W. J. C. H.

Decision

Matter of: Department of Labor - Disposition of Refunded
Social Security Contributions

File: B-218922

Date: May 18, 1987

DIGEST

Internal Revenue Service refunded Social Security contributions previously paid over by Department of Labor (DOL) contractor. Refund included portion which had been withheld from employee wages and an equal amount contributed by contractor as employer. Portion of refund representing employer's contribution should have been returned to DOL as an unallowable contractor cost. However, contractor erroneously distributed more than half of the total refund to some former employees. Balance of refund, now in hands of DOL, should be viewed -- as partial return of unallowable contract costs and retained by DOL for credit to disbursing appropriation, and DOL should pursue claim for balance due.

DECISION

This decision responds to a request from the Employment and Training Administration (ETA), Department of Labor (DOL), for guidance concerning the proper treatment of Federal Insurance Contribution Act (FICA) taxes refunded by the Internal Revenue Service (IRS) to SER-Jobs for Progress, Inc. (SER). DOL officials advise us that SER performed job training services on a cost-reimbursable basis pursuant to the Manpower Development and Training Act of 1962 (MDTA), Pub. L. No. 87-415, 76 Stat. 23 (1962).^{1/}

BACKGROUND

During the years 1971-73, SER employed several hundred MDTA program employees. During this period, SER withheld FICA taxes from the wages of its employees and submitted them to the Government, along with an equal share

^{1/} According to DOL officials, SER was awarded contract numbers MDTA 006-2-0502-000; 099-3-003-001; and 099-4-008-007. Our Office was not provided copies of the contracts themselves.

038966

of employer's taxes.^{2/} The employer's tax payments were charged to the Government as administrative costs. Subsequently, the IRS ruled that SER and its employees were exempt from the requirements of FICA and refunded to SER \$442,644. This refund consisted of equal amounts of previously submitted employer and employee taxes, including interest earned on both shares.

Upon receiving the refund, SER took the position that both the employees' and employer's shares belonged to the former SER employees and, therefore, both shares should be considered as allowable contract costs. Consistent with this position, SER distributed approximately \$310,600 to a group of its former employees.^{3/}

In contrast to SER's position, DOL auditors questioned whether the refunded FICA taxes could still be considered as administrative expenses chargeable against the MDTA contracts. On January 4, 1980, the DOL contracting officer responsible for these contracts issued a Final Determination concerning the proper disposition of the refunded taxes. The contracting officer concluded that the portion of the refund representing the employer's taxes, along with the interest earned thereon, did not constitute a proper charge against the contracts and should be returned immediately to DOL. SER apparently refused to comply with that ruling.

^{2/} The Social Security Act and its subsequent amendments provide a system of old age and unemployment benefits. 26 U.S.C. § 3101 et seq. (1982). These benefits are supported by various taxes including FICA taxes. The FICA tax is a tax paid in part by employees through withholding (26 U.S.C. §§ 3101, 3102), and in part by employers through an excise tax (26 U.S.C. § 3111). Both the employer's and employee's portions of the FICA tax are based on the wages paid employees, and the recordkeeping and transmittal of funds are obligations of the employer.

^{3/} Documents that we reviewed indicate that 168 former SER employees received refunds of both the employees' and the employer's share, along with interest earned on both shares. An additional 12 employees received only the employees' share, with interest. Finally, 290 employees received no distribution. We were unable to determine SER's rationale for disbursing the funds in this manner. The dollar amounts given in various documents in the record are not in total agreement. Hence, monetary figures in this decision are intended as approximations only.

On December 12, 1982, as a result of continuing efforts to resolve the matter, SER and DOL executed a "Memorandum of Understanding" under which SER transferred to DOL all funds remaining in its FICA refund account.^{4/} Thereupon, DOL officials discussed the proper disposition of the FICA refund with the Social Security Administration (SSA), IRS, and DOL/ETA's Office of the Solicitor. None of these discussions effectively resolved the matter. DOL now presents our Office with the following questions:

- 1) To whom is the "employer's share" legally due?
- 2) Does DOL/ETA have the authority to disburse the "employees' share" directly to former SER employees?
- 3) Is SER legally liable to the Government for the portions of the "employer's share" it disbursed to former employees?

DISCUSSION

We first consider who is legally entitled to the "employer's share" of the FICA refund. We conclude that this portion of the refund properly reverts to the Government.

The legislation requiring an employer to pay FICA taxes is codified at 26 U.S.C. § 3111. This section states:

"* * * there is hereby imposed on every employer an excise tax, with respect to having individuals in his employ * * *."

The courts have long held that an employer's FICA contribution is a tax "levied upon the privilege of establishing and maintaining the relationship of employer and employee." See Steward Machine Co. v. Davis, 301 U.S. 548 (1937); Jones v. Goodson, 121 F.2d 176, 179 (10th Cir. 1941).

^{4/} Eventually, a total of slightly over \$185,630 was transferred from SER to DOL pursuant to this agreement. The sum of the amount returned to DOL and the amount SER had already distributed exceeds the amount refunded by IRS. The difference is attributable to interest SER had earned on the refund, and a FICA refund from another project unrelated to this case.

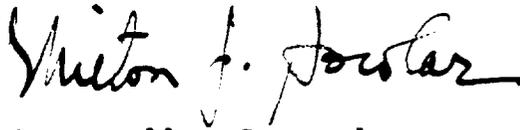
Based on the clear language of the legislation and prior law, we must conclude that SER's FICA contributions were originally a tax to SER and therefore a cost of doing business for which the contractor was reimbursed by DOL under the terms of the contract. Upon IRS' determination that the expenditure was unnecessary, the previously paid tax was no longer a legitimate business expense. We agree with the DOL contracting officer that the "employer's share" (\$221,322) of the FICA refund was not an expense to SER and therefore was not an allowable cost under the contracts. Accordingly, those funds properly revert to the Government.

Turning now to the so-called "employees' share," our review of the record indicates that the division of the amount returned to DOL into "employer's share" and "employees' share" originated from SER's own calculations. In our view, this treatment was neither legally compelled nor legally justified. The only required division was that half of the total amount refunded by IRS should have been returned to the former employees and half should have been returned to DOL.^{5/} The fact that SER, in erroneously distributing more than half of the total refund to some former employees omitted other former employees, does not alter the fact that half of the total refund was owed to DOL. It is SER that made the erroneous distribution, and it is therefore SER, not DOL, that should bear the consequences. Accordingly, with respect to the funds which SER has returned to DOL, we find no basis for treating those funds as anything other than a partial return of the "employer's share" of the FICA refund. Viewed from this perspective, DOL is not holding any "employees' share." DOL should therefore retain the funds, for credit to the appropriation originally charged. More specifically, since it has been over 2 years since that appropriation was available for obligation, the monies should be credited to the applicable "M" account. 31 U.S.C. § 1552(b) (1982). Any claims by former employees who did not receive their

^{5/} Documents submitted to us suggest that there may have been 12 former employees for whom no employer share was paid, but we cannot determine this with certainty from the record. If this is true, then the amount of DOL's claim against SER should be adjusted accordingly.

full refund are properly directed against SER, not the United States.

DOL's third question is whether SER is liable to the Government for the portion of the "employer's share" it improperly disbursed to former employees. The answer is yes. The fact that SER no longer has possession of funds which it improperly disbursed does not provide a basis for relieving SER of its responsibilities under the contracts. Accordingly, we conclude that SER is liable to DOL for the difference between the total "employer's share" refunded by IRS and the amount SER previously returned to DOL. DOL should pursue appropriate collection efforts to recover these funds.



Acting Comptroller General
of the United States